

Tax Increment Financing (Again)

2010 “Sunset” Provision is Repealed

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On March 12, 2002, Governor Locke signed Substitute House Bill 2592 (Chapter 12, Laws of 2002). This bill remedied one of the fatal flaws in the tax increment financing (“TIF”) statutes enacted in 2001 – it repealed the 2010 expiration date applying to such statutes. The bill also made certain “housekeeping” amendments to clarify the existing statutes. The amendments take effect on June 13, 2002.

Those of you following the recent efforts to bring TIF to Washington State understand that the repeal of the “sunset” provision is big news. Many more TIF projects will be financially feasible because the tax allocation scheme established by chapter 39.89 RCW can extend for an indefinite period of time. In light of this significant change, we are providing a revised summary of the TIF laws.

The Law

Chapter 212, Laws of 2001 (generally codified in chapter 39.89 RCW), as amended by Chapter 12, Laws of 2002.

Chapter 39.88 RCW, the prior TIF statutory scheme, was ruled unconstitutional in *Spokane v. Leonard* (1995) on the grounds it diverted tax revenue intended to support the common schools. (The voters rejected attempts in 1973, 1982 and 1985 to amend the Washington Constitution and authorize tax increment financing.)

Who Can Initiate TIF Projects?

Cities; counties; and port districts.

Which Local Governments Are Authorized to Participate in TIF Projects?

Rural county library districts; intercounty rural library districts; metropolitan park districts; counties; park and recreation service areas; park and recreation districts; road districts; fire protection districts; port districts; public utility districts; cultural arts, stadium and convention center districts; cemetery districts; public hospital districts; and flood control zone districts.

What Is TIF?

Designated “community revitalization financing” in the Washington statutes – but commonly known as “tax increment financing” – TIF generally refers to a financing mechanism that allows a local government to “trap” increased property tax revenue resulting from the growth of assessed value within an increment area. This tax revenue services debt issued to finance public improvements that spur private development within the increment area.

Unlike other tax increment laws around the Country, Washington’s TIF laws do not authorize the issuance of special revenue bonds. Rather, such laws merely provide an additional source of revenue (*i.e.* a portion of the regular taxes levied by other taxing districts) to apply toward debt service on the issuer’s general indebtedness.

What Is an “Increment Area”?

An “increment area” is a geographic area within the city, county or port district that creates the increment area. In this sense, increment areas are similar to local improvement districts.

How Are Increment Areas Created?

By the adoption of an ordinance (in the case of cities) or a resolution (in the case of counties and port districts) after a public hearing is held regarding the proposed financing of the public improvement. Unlike laws relating to local improvement districts, the TIF laws do not: (i) require that notice be mailed to property owners within the proposed increment area; (ii) establish protest procedures; or (iii) limit the authority to create an increment area if protests are made at the hearing.

Do Cities, Counties and Port Districts Have Free Reign to Create Increment Areas?

No. Various factors must be present before an increment area can be created—(i) the entity creating the increment area must expect that the proposed public improvements will encourage private development and increase the fair market value of real property within the increment area, (ii) the anticipated private development must be consistent with countywide planning policies adopted under the Growth Management Act, and (iii) the anticipated private development must be consistent with the entity’s comprehensive plan and development regulations adopted under the Growth Management Act. The ordinance/resolution creating the increment area must contain findings in this regard.

What Are the Purposes for Which TIF Is Authorized?

Tax allocation revenues can be spent only “to finance public improvement costs associated with the public improvements financed in whole or in part by community revitalization financing.”

How Are “Public Improvement Costs” Defined for Purposes of the TIF Laws?

“Public improvement costs” are defined broadly. They include costs of design, planning, acquisition, construction, rehabilitation, improvement and installation of “public improvements;” relocation costs; and financing costs.

Which “Public Improvements” Are Authorized by the TIF Laws?

The phrase “public improvements” includes more than bricks and mortar (and its use throughout the statutes is awkward as a result). “Public improvements” are defined to mean (i) “infrastructure improvements” and (ii) “expenditures” for environmental analysis, professional management, planning, promotion within the increment area, management and promotion of retail trade activities in the increment area, maintenance and security for common or public areas in the increment area, and historic preservation activities.

While maintenance, security and promotion expenditures are defined to be “public improvements,” such expenditures are not included within the definition of “public improvement costs.” If read literally, the only way tax allocation revenue can be used to pay for maintenance, security and promotion within the increment area is if bonds are issued to finance such expenditures.

What Are “Tax Allocation Revenues”?

Those tax revenues derived from the imposition of “regular property taxes” on 75% of any increase in the true and fair value of real property in an increment area that is placed on the tax rolls after the increment area is created. The entity creating an increment area can agree to take less tax revenue than the maximum allowed by the TIF laws, so long as bond debt service, bond reserve, and other bond covenant requirements are satisfied. Under such circumstances, the “tax allocation revenues” would be the tax revenues actually distributed to finance the public improvements.

What Taxes Are Subject to TIF Allocation?

“Regular property taxes,” which are defined for TIF purposes to mean property tax levies that (i) are subject to the aggregate limitation set forth in RCW 84.52.043 (*i.e.* the “\$5.90 per \$1,000 assessed value” limitation) and 84.52.050 (*i.e.* the “one percent” limitation), or (ii) are levied by a port district or a public utility district.

What Taxes Are Excluded from TIF Allocation?

- Regular property taxes levied by the State for the support of the common schools;
- Regular property taxes levied by a port district or a public utility district, to the extent the port district or public utility district specifies (*e.g.* in the resolution submitting the levy request to the county assessor) that the tax receipts will be used to make required debt service payments on general indebtedness;
- Voter-approved regular property tax levies to fund emergency medical services;

- Regular property taxes levied by counties under RCW 84.34.230 to fund the acquisition of open space and conservation futures;
- Voter-approved regular property tax levies by counties, cities and towns to fund affordable housing for low-income households; and
- Certain voter-approved regular property taxes levied by metropolitan park districts.

What Is the Maximum Levy Rate Subject to TIF Allocation?

The maximum levy rate subject to allocation under chapter 39.98 RCW is \$7.70 per \$1,000 of assessed value of taxable property. However, it is *highly* unlikely that regular property taxes within an increment area would be levied at such an aggregate rate. Under existing laws, this can only occur if: (i) the aggregate levy rate within the increment area for all taxing districts subject to RCW 84.52.043 is \$5.90 per \$1,000 of assessed value; (ii) a port district is levying regular property taxes within the increment area for general purposes, dredging purposes and industrial development purposes (*e.g.* for an aggregate levy rate of \$1.35 per \$1,000 of assessed value); (iii) a public utility district is levying regular property taxes within the increment area (*e.g.* for an aggregate levy rate of \$0.45 per \$1,000 of assessed value); *and* (iv) neither the port district nor the public utility district has specified that the receipts from such tax levies will be used to pay debt service on general indebtedness.

When Are Tax Allocation Revenues First Distributed?

During the year after the increment area is created.

Who Allocates the Assessed Values for TIF Purposes?

The county assessor. The TIF laws do not authorize a county assessor to revalue property within the increment area unless the revaluation is pursuant to the assessor's revaluation plan. In other words, assessors are not authorized to make special revaluations solely to accommodate TIF financing.

Who Distributes Tax Revenues for TIF Purposes?

The county treasurer.

Is TIF Financially Feasible?

Yes, under certain circumstances. Assessed value within an increment area must increase by approximately \$18 million to support each \$1 million of TIF bonds. Stated conversely, approximately \$55,000 of TIF bonds can be supported by each \$1 million increase of assessed value within the increment area. These estimates assume various factors, including (i) a 20-year bond amortization period; (ii) an interest rate of 5% per annum; (iii) the tax allocation revenues will be based on an aggregate regular property tax rate of \$5.90 per \$1,000 of assessed value; and (iv) the entity creating an increment area is entitled to 75% of the increase regular property tax revenues resulting from the growth of assessed values within the increment area.

When Does the Tax Allocation Process Terminate?

The TIF tax distribution scheme terminates when tax allocation revenues are no longer necessary or obligated to pay the costs of the public improvements. Because the “sunset” provision was removed from the TIF laws in 2002, a tax allocation program can be extended for an indefinite period of time. Other taxing districts may require a specific terminate date in the written agreements required by the TIF laws.

Can Members of the Public Halt the TIF Creation Process?

Yes, but in a very limited way. A member of the public can challenge the validity of the TIF statutes or the formation process. However, any such challenge must be commenced within 30 days after notice is published regarding the creation of the increment area.

Can Other Local Governments Halt the TIF Creation Process?

Yes. Fire protection districts have ultimate “veto” power over the creation of the increment areas. A fire protection district must agree to participate in the TIF project for the project to proceed.

In addition, taxing districts that levy at least 75% of the regular property tax within the increment area must approve the TIF project by means of a written agreement. A TIF project cannot proceed without this agreement.

What Risks Are Unique to Local Governments Issuing TIF Bonds?

The entity creating an increment area will receive *no* tax allocation revenues if the assessed value of the increment area declines below its original amount, or if a court determines the TIF is unconstitutional.

Washington’s newest TIF laws have not been tested in court. While they appear to address many of the shortcomings of the prior laws, there can be no guarantee the new laws are constitutional.

TIF bonds are payable from tax revenues. As a result, such bonds are treated as “general indebtedness” under the TIF laws. This is consistent with court decisions construing the Washington Constitution. Although “nonpublic participants” in TIF financings may be required to provide “adequate security to protect the public investment” in the increment area, the issuer’s general fund ultimately may be at risk to the extent tax allocation revenues are insufficient to pay debt service on TIF bonds.

Because TIF bonds will be a “general indebtedness,” such bonds will count against an issuer’s constitutional and statutory debt limits.

Observations and Suggestions

Municipalities that are considering whether to create an increment area should prepare a detailed analysis of the historical and anticipated tax levy rates within the proposed increment area, as well as the purpose of each such tax. This analysis should consider the potential impacts of future limitations on the amount by which regular property taxes can increase—such as the limitations imposed by Initiative 747. Only after such

an analysis is prepared can one estimate the aggregate tax rate that should be used in projecting future tax allocation revenues for a specific increment area.

Because significant increases in assessed value of property must occur in the increment area before tax allocation revenues will be sufficient to finance meaningful improvements, community revitalization financing favors projects involving undeveloped and under-developed property (*i.e.* where the potential for growth in assessed value is the greatest).

TIF bonds will be most useful if they are issued in conjunction with other types of bonds, such as revenue bonds or special assessment bonds, or if additional sources of revenue are pledged to the payment of TIF bonds.

For political reasons, a city, county or port may be required to distribute a portion of their tax allocation revenues to other taxing districts (*e.g.* if necessary to secure the consent of those taxing districts.)

Until a court passes upon the constitutionality of the TIF laws, it is unlikely that any bond counsel firm will be willing to render an unqualified approving opinion regarding bonds that are solely secured by tax allocation revenues. Such opinions likely will be rendered for general obligation bonds that are secured by a pledge of the issuer's full faith and credit (even if tax allocation revenues are expected to be the primary source of repayment).

We look forward to working with our clients as they consider this new economic development tool.